Unitil
Unitil Service Corp.

February 21, 2006

HAND-DELIVERED

Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station, 2nd floor
Boston, MA 02110

Re: Response of Fitchburg Gas and Electric Light Company d/b/a Unitil to the Request for Comments D.T.E. 05-GAF-P4

Dear Secretary Cottrell:

Pursuant to the Department of Telecommunications and Energy's ("Department") Request for Comments issued in the above-referenced docket on February 3, 2006, Fitchburg Gas and Electric Light Company d/b/a Unitil ("Unitil") provides the following response.

Introduction

On December 15, 2005, Unitil submitted its Cost of Gas Adjustment Clause ("CGAC") Compliance Filing to revise its September 16, 2005 Form II CGAC. Unitil made this filing in response to the Department's order with respect to Bay State Gas Company ("Bay State") in D.T.E. 05-27, issued on November 30, 2005, which allowed for an amended Bad Debt Cost Factor, a component of the CGAC. Unitil also requested approval of the recovery of its under-recovered gas cost-related bad debt for calendar year 2005.

As discussed in Unitil's December 15, 2005 filing letter, D.T.E. 05-27 provided for a revised method for the allocation of gas cost-related bad debt to the CGAC, allowing for the recovery of actual costs. This order reversed the Department's decision in D.T.E. 02-24/25 which had limited CGAC bad debt recovery recovery to a fixed level of bad debt approved in a utility's rate case.[1] The Department had based its

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[1] On November 21, 2005 Unitil submitted a letter to the Department in response to the Department's request that the shut-off extension period be extended from March 15, 2006 to May 1, 2006. As discussed in that letter the fixed level of bad debt recovery

decision to limit bad debt recovery in this manner on its expectation that as customers migrated to competitive supply, gas cost-related bad debt would decrease because the supplier of such customers would be responsible for their bad debt. The expected migration of customers to transportation did not occur, and as a result, rather than decreasing, Unitil's bad debt costs have been under-recovered each year since implementing the D.T.E. 02-24/25 method of bad debt recovery.

The Department has recently issued two significant decisions concerning the recovery of gas cost-related bad debt through the CGAC. In D.T.E. 05-66, the Department determined that the increase experienced by Boston Gas Company d/b/a Keyspan Energy Delivery New England's ("Keyspan") in its gas cost-related bad debt expense was due to "unprecedented increases in gas commodity prices that have affected the level of the Company's gas related bad debt expense" and that "the cost changes associated with changes in market conditions that uniquely affect the local gas distribution industry are beyond the Company's control." (D.T.E. 05-66, *Slip Op.* at pages 11, 13.) Accordingly, the Department allowed Keyspan to recover its under-recovered bad debt costs for the period of January 2004 through December 2004 through its 2005-2006 peak gas adjustment factor as exogenous costs to the company's rate plan. The Department also stated that it would allow Keyspan to continue this recovery until the Department issued a consistent rule concerning bad debt cost recovery through the CGAC.

The Department addressed the CGAC recovery of bad debt in D.T.E. 05-27, Bay State's base rate investigation. Having previously established the constitutional implications of limiting bad debt expense recovery in D.T.E. 05-66, the Department in D.T.E. 05-27 recognized that fixing the total amount of uncollectible expense in a base rate proceeding could have a significant effect on a company's earnings.

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for Unitil's gas and electric divisions established in D.T.E. 02-24/25 is based upon an annualization of the write-offs booked in January through November of the test year. This calculation eliminated the higher level of write-offs booked in December of the test year, which the Department acknowledged were due to higher commodity costs and a moratorium on winter shut-offs. The Department determined that the moratorium was an extraordinary event "not likely [to] occur in future years." D.T.E. 02-24/25, *Slip. Op. at 169.*

In D.T.E. 05-27, the Department determined that the ratemaking treatment and recovery method for gas cost-related bad debt expense established in D.T.E.02-24/25 no longer achieved the Department's rate structure goals (Order at pp. 183-184), and approved Bay State's proposal to collect and recover its gas cost-related bad debt on a reconciling basis. The order also invited Keyspan, and by implication, Unitil, to submit a revised CGAC filing for effect on January 1, 2006. The December 15, 2005 filing by Unitil was submitted in compliance with that order. Unitil seeks the recovery of its under-recovered gas cost-related bad debt for calendar year 2005, and submits that such recovery would not constitute retroactive ratemaking, is not otherwise prohibited, and would be consistent with the public interest and the orders issued in D.T.E. 05-66 and D.T.E. 05-27, as previously discussed.

On February 3, 2006, the Department issued a Request for Comment in this docket containing two briefing questions that are related to Unitil's request.

Briefing Question No. 1: Is the referenced case applicable where a change in Department policy, as opposed to an error in calculation, occurs?

In its December 15, 2005 filing, Unitil cited to Fitchburg Gas and Electric Light Company v. Department of Telecommunications and Energy, 440 Mass. 625 (2004) in support of its request to collect its 2005 under-recovered gas cost-related bad debt through the CGAC. Unitil submits that recovery of these amounts would not constitute retroactive ratemaking, because, as decided in Fitchburg, the limitations on retroactive ratemaking applicable to base-rate changes do not apply to the CGAC reconciling mechanism.

In Fitchburg, Unitil appealed a Department determination that the company overcharged its gas customers by including inventory finance charges (IFCs) in both its base rate and its CGAC. The Department had ordered the company to refund the overcharge initially collected via the CGAC back through CGAC to its ratepayers. On appeal, the Massachusetts Supreme Court considered whether the Department's refund order constituted retroactive ratemaking. The Supreme Court concluded that an order retroactively adjusting a CGAC "is well within

the department's general supervisory authority over utility costs. . . . and is consistent with its 'broad authority to determine ratemaking matters in the public interest.'" *Id.*, at 637 (citations omitted).[2]

The Department questions whether the Supreme Court's determination in Fitchburg that a retroactive adjustment of a CGAC is permissible is applicable to situations where the *purpose* of the CGAC's retroactive adjustment is to implement a change in Department policy. The Court in Fitchburg did not address this question directly, and only went so far as to state that the CGAC formula "is a fixed 'rate' that cannot be changed outside the hearing procedure mandated by G.L. c. 164, § 94." (*Id.*) Clearly, the requirement of a hearing has been followed. The CGAC "formula" for the recovery of gas-supply-related bad debt expenses applicable to local gas distribution companies was changed by the Department pursuant to a hearing in docket D.T.E. 05-27. Having complied with the requirement to hold a hearing, there is nothing in Fitchburg that would prohibit the application of the new CGAC formula on a retroactive basis.

The rule against retroactive ratemaking is essentially a rule against retroactively altering base rates, and exists as a matter of statutory construction of G.L. c. 164, §94. *Id.* Fuel clauses such as the CGAC have a distinct legal basis, and have been distinguished based upon their design as a flexible instrument to enable companies to recover the actual cost of gas purchased. It is expected that changes will be made to a fuel clause to adjust for under-or over-collections once actual cost figures, rather than estimates, are available. Blackstone Gas Co., D.P.U. 511 (1981). The Supreme Court noted in Fitchburg that the amounts recovered through the CGAC represents costs over which utilities have little or no control, and it would defeat the purpose of the clause to require that these costs be frozen until a rate investigation is completed. *Id.* at 638.

Whether the retroactive application of a new Department policy through the CGAC would be a violation of the general prohibition

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[2] "Retroactivity is inherent in the very nature of a CGAC. Unlike the base rate, which is a calculation of rates going forward based on historical data, the CGAC adjusts semi-annually for utility costs as they actually have been incurred, according to a mechanically applied technical formula." *Id.*

against retroactive ratemaking or be allowable as an accepted retroactive application of a reconciling mechanism would be dependent upon the nature of the policy change: is it to effect a "base rate" type change or is it more of an adjustment to correct the calculation of the CGAC so that it more closely recovers the actual commodity costs. Unitil submits that the rule against retroactive ratemaking would not be violated by the retroactive application of the revised CGAC formula so as to allow the company to recover its 2005 gas cost-related bad debt costs. This is because the clause would be employed solely to correct for past under-recoveries of these amounts and thereby recover the company's actual gas costs. This type of adjustment is, as expressed in Fitchburg, "inherent in the very nature of a CGAC." *Id.*

There is additionally, however, a Constitutional dimension to this issue, as has been explicitly recognized by the Department in D.T.E. 05-66: the right of a regulated company to be given an adequate opportunity to recover the reasonably incurred costs of providing required service so as to preserve its financial integrity and attract capital. The Department found that the extreme wholesale gas prices coupled with the unintended effects of the bad debt recovery methodology put in place in D.T.E. 03-40 effectively denied Keyspan its constitutionally protected opportunity to earn a reasonable return. In doing so, the Department determined that the constitutional infirmity was inherent in the methodology it had put in place in D.T.E. 03-40, and the recovery through the CGAC from that point forward had been insufficient to provide an adequate opportunity to earn a reasonable rate of return. It was, therefore, not sufficient to simply provide for a prospective change of the methodology of bad debt collection. "The matter has also been raised here in D.T.E. 05-66 *and must be answered.*" D.T.E. 05-66 at 16 (emphasis supplied.) Keyspan's recovery of its under-recovered bad debt amounts as an exogenous cost to its rate plan was therefore necessary to remedy the constitutional defect in its CGAC.

The same analysis is applicable to Unitil: the Department has already determined that the bad debt methodology that Unitil was directed to apply in D.T.E. 02-24/25 is incompatible with constitutionally sound regulation because it denies recovery of costs which are necessary to meet service obligations and which are largely beyond the company's control. Since this infirmity is inherent in the bad debt

recovery method itself, which has been in place since the last rate order, it is not sufficient to limit Unitil's remedy to the prospective recovery of its actual gas-supply related bad debt costs, particularly when it has experienced large under-collections of these amounts. Thus, retroactive application of the new CGAC formula is not merely permissible under Fitchburg and consistent with the purpose of the fuel clause, it is required to remedy the same constitutional defect in Unitil's CGAC as was found in Keyspan's, and for the same purpose.

As with Keyspan and Bay State, there is no question that wholesale gas costs have been and remain beyond the control of Unitil. As with Keyspan and Bay State, Unitil must purchase gas to meet the throughput demand of its customers and has no control over the prevailing conditions or prices in the wholesale market. Unitil's gas supply costs have consistently been in the middle range of such costs charged by utilities within Massachusetts, and its customers have experienced the same price volatility and extreme prices as Keyspan's and Bay State's customers. Further, Unitil has prudently managed its gas costs purchases and has successfully kept its bad debt costs within reasonable levels.

Under these circumstances, Unitil submits that the retroactive application of the new gas-supply bad debt cost recovery methodology through the CGAC is not only permissible, but is necessary to avoid denying Unitil its constitutionally protected opportunity to earn a reasonable return.

However, the issue the Department poses - whether Fitchburg's approval of a retroactive adjustment of the CGAC is applicable where a change in policy occurs - need not be reached in this case in order to approve FG&E's request. Simply stated, no policy change has occurred. The Department's initial decision to require gas distribution companies to allocate a portion of bad debt to the GAF was made in D.P.U. 96-50 (Phase I). This policy remains in place. A representative level of uncollectible expense is included in base rates, and that remains unchanged. What has occurred is very limited: the methodology by which the portion of uncollectible expense allocated to the CGAC is recovered has been revised.[3] As stated above,

[3] In D.T.E. 05-24/25 the Department characterized the change in bad debt recovery as a "revised method" or a "refinement of the method" from that put in place in D.P.U.

retroactive application of this new formula is not prohibited by Fitchburg, and is consistent with the very purpose of the CGAC.

Briefing Question No. 2: When the Department implements a new methodology for calculating costs, does the CGAC reconciling mechanism permit recovery of costs resulting from that new methodology on a retroactive basis?

As discussed above, Unitil submits that the retroactive application of a new methodology for calculating costs to be recovered through the CGAC is permissible as evidenced by the Department's decisions in D.T.E. 05-66 and D.T.E. 05-27, does not violate the general rule against retroactive ratemaking articulated by the Supreme Court in Fitchburg, and it is consistent with the intent and purpose of the CGAC in providing for recovery of commodity costs which are necessary for the provision of service and beyond the control of the utility. Indeed, the Department has provided for retroactive application of such new methodologies elsewhere in the past, where it has determined that the public interest would be served by such action.

For example, in D.T.E. 99-32, issued September 15, 1999, the Department authorized Unitil to implement its proposed methodology for the financing of gas costs effective as November 30, 1998. The Department determined that since Unitil had removed inventory financing charges from its CGAC on December 15, 1998 and therefore had not recovered these expenses since November 30, 1998, it would permit the company to reconcile the actual costs incurred since that time at the time of its next peak CGAC filing. The Department stated that this recovery was consistent with the reconciliation purpose of the CGAC and was not retroactive ratemaking.

More recently, in D.T.E. 01-106-C, the Department approved the establishment of a Residential Assistance Adjustment Factor ("RAAF") for gas and electric distribution companies. Through the RAAF, a distribution company collects the difference between the distribution revenue for the usage of customers under the low-income discounted rate and the regular residential rate. The order established a baseline

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96-50. Thus, the change announced in D.T.E. 05-27 back to a methodology which more closely resembles that originally put in place in D.P.U. 96-50 can only be similarly described. It is certainly not a change in "policy."

amount calculated as the difference between the base rate revenues that would have been collected from customers receiving the low-income discount during the year ending June 30, 2005, had no low-income discount existed, and the actual base rate revenues collected from low-income customers for the twelve months ending June 30, 2005. On or after July 1, 2005, however, the amount of the low-income discount in excess of the baseline amount became eligible for recovery through the RAAF, though the RAAF itself was first approved by order on October 14, 2005.

In Blackstone Gas Co., DPU 511 (1981) the Department allowed a utility to recover more than five years of prior under-collections through a CGAC. The Department noted that "the CGA factor was designed as a flexible instrument which would enable companies to recover the actual cost of gas purchased . . . . [I]t is expected that changes will be made in the CGA to adjust for past over/under-collections once actual cost figures, rather than estimates, are available." Unitil submits that this is very similar to what it is requesting occur in the present case. The recovery for bad-debt expenses afforded Unitil in D.T.E. 02-24/25 was based upon an amount which was estimated by the Department to be reasonable on a prospective basis, given certain assumptions about the direction of the transportation supply market. Now that Unitil's actual bad-debt cost under-collections are available, and the Department has determined that the historically extreme wholesale gas prices and the unforeseen and unintended effect of D.T.E. 02-24/25 on gas-related bad debt expense recovery would deny a company its constitutionally protected opportunity to earn a reasonable return, Unitil is requesting that it be permitted to recover its actual under-collected gas-related bad debt costs. The very purpose of a reconciling clause is to adjust for past over-or under-collections, and therefore an order by the Department retroactively applying the new CGAC bad-debt recovery methodology is well within its authority, and consistent with the public interest.

Conclusion

For the reasons discussed above, Unitil submits that the CGAC reconciling mechanism requires the retroactive recovery of costs resulting from the application of a new methodology of cost calculation in instances where such costs are necessary for the provision of

service, are beyond the control of the company, and where the incurrence of these costs by the utility has been reasonable.

Respectfully submitted,

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